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on Risk Management
(see centerfold)**

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA

The Practicing CPA

DECIDING IF A MERGER IS RIGHT FOR THE FIRM

Today, there are many reasons for a CPA firm to seriously consider pursuing a merger as a growth strategy. Consolidators are acquiring CPA firms and the profession is developing additional services for firms to offer. Often, these additional services are also offered by non-CPAs. Although colleges and universities are in the transition phase of converting their auditing courses into courses on auditing, attestation, and assurance services, not many CPAs can claim an academic background in these new services.

The future of CPA firms may be to either grow into a broader more diversified firm or become a boutique firm specializing in a small area of practice. Either way, the firm should plan its direction and focus on where it is going. If the firm decides to expand its scope of practice, mergers and acquisitions may be an excellent device for acquiring the expertise and client base to provide the services. However, the planning for where the firm is going should precede the mergers and acquisitions. A review of the fundamentals that the firm should cover when contemplating its future follows.

The firm's current characteristics

Firm owners need to understand where the firm is today to plan for the future. To do this, owners should have a number of statistics on hand—specifically, concerning services, staffing, profitability, and the factors contributing to profitability. Some of these may be readily available to the firm from its time and billing system, whereas others may not be and will require a little digging.

Services. The firm should categorize its fee generation by the categories of work it performs. The standard categories of audit, tax, accounting, and management advisory services come to mind. However, firms should be more specific. Firms with a large audit practice may wish to identify audits for school districts, governments, health care, not for profits, or other significant client groups. Taxes may be broken down into compliance and consulting or personal and corporate. Management advisory services should be classified into areas where the firm has a niche or wants to develop one, such as pension support, financial planning, litigation support, valuation, computer consulting, and systems analysis.



Staffing. The firm should express its staffing by category and in terms of full-time equivalents (FTEs). The categories should include, at a minimum, owners, professional staff, and support staff. Many firms may want to break these categories down further or add paraprofessional or other categories. Each staff member is either a full-time person or some "portion" of a person. If the firm has specific expectations for the hours a particular category of person should produce in a year, this number can be used to determine FTEs. If the firm does not have such a specific expectation (but it should), the average number of hours for staff in a particular category can be used.

Once a firm's FTE is identified, it should measure its leverage and utilization. Leverage is the ratio of staff to owners. It is an indication of the effectiveness of the owners in managing staff. Two common leverage indicators are total employees leverage (overall firm FTEs/owners) and professional staff leverage (professional staff FTEs/owners). Utilization measures the productivity of the staff. This can be expressed in total chargeable hours per FTE, per category, and as a percentage of the total hours worked.

It is also worthwhile to track the nonchargeable hours by categories. Examples are professional development, practice development, and promotion, along with holidays, vacation, sick time, personal time, and general office time.

Profitability. Profitability can be expressed in two ways. The most common is the profit per owner before any owner compensation. The other requires dividing owner compensation into two component parts: fair compensation and the return on their investment in the firm, and then adding fair compensation to expenses. This provides a better picture of actual operating profits of the firm and eliminates distortions in comparing firms that have a high concentration of owners with those that have a low concentration of owners. The challenge with this method is identifying fair compensation. Some firms may have a comprehensive compensation formula for owners that identifies hours worked, new business brought to the firm, and goals achieved. If the results of this process are reasonable, it is likely that the results represent fair compensation. If the owners merely take out all earnings, fair compensation

needs to be identified. One possible method is to base the fair salary of owners on a comparison with the fair salary and billing rate of another group of employees. For example, a senior manager has a billing rate of \$100 per hour and an annual salary of \$50,000; the owner has a billing rate of \$200 per hour. In this scenario, the owner's annual fair salary would be \$100,000.

Profitability factors. Only three significant factors are considered in the profitability of CPA firms: (1) billing the staff at a high multiple of what they are paid, (2) realizing that rate when the firm bills the client, and (3) keeping the staff productive. If a firm keeps its staff billable a high percentage of the time, and the standard fees generated are at a reasonable multiple and can be collected, the firm will be profitable. The following indicators of these profitability factors can be calculated: billing rate per person, average billing rate by category of staff (fees at standard/chargeable hours), realization rate (net fees/fees at standard), and volume and hours managed per owner. The firm's hourly billing rates are determined by considering the marketplace, the value of the services to the client, and the hourly cost of the person providing the service. Most firms strive for a billing multiple of three or more times the hourly cost of the staff person.

The average profitability per owner is a function of leverage. The profitability of the individual owner is then determined by the individual's share of the earnings. This fact may be an influencing factor in deciding how many owners a firm should have. Many firms define the number of owners they will have as a function of chargeable hours per owner or dollar volume. One analysis of firms indicated an average of approximately 10,000 hours per owner is the norm.

Firm philosophy

Now that the firm has a picture of its financial situation, it can deal with what it wants to be, realistically, and measure the impact on its current financial profile. The firm needs to deal with its philosophy in terms of our responsibilities to the public as CPAs, our profession, our clients, our staff, and ourselves, and how these may affect growth.

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The public. We should consider what we feel our responsibility is to the public. This may be expressed in terms of our:

- Obligation to maintain a competent and adequate organization, to render efficiently the services offered. Sole practitioners offering just tax services can probably meet this obligation without any growth. However, sole practitioners who practice in areas of tax, auditing, and management advisory services probably need to have assistance in meeting the demands of keeping up with changes in these areas. The practitioner may well decide that he or she needs professional staff or co-owners to meet his or her obligations.
- Obligation to maintain objectivity, impartiality, and independence in every assignment. Some small firms have one large significant client. To maintain the appearance of independence, the firm may seek growth. Some firms define a specific percentage of gross fees that they do not wish to exceed with one client. The firm should deal with whether they are

interested in performing services with commissions and contingency fees and the impact on the public's perception of their firm.

- Obligation to support the communities we are involved in and be participating citizens. We are fortunate to belong to our profession and hold a position of respect in our community. With this good fortune many of us feel that they should give something back to the community. On the other hand, work seems to consume them, and any spare time goes to the family, who deserves to have their attention. Thus, no time seems to be available. If this obligation has any chance of being met, there may be a need for lower hourly demands in the office and, as a consequence, the need to have more staff and sacrifice some profitability.

Our profession. The profession is the sum of the individual members contributing to the overall practice of accounting. We can decide what our participation should be by considering our:

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SEC VOTES ON AUDITOR INDEPENDENCE RULE; SMALL FIRMS PROTECTED

The following article will appear in December 2000 issue of The CPA Letter.

Commissioners of the Securities and Exchange Commission voted unanimously Nov. 15 on a compromise to its proposed rule on auditor independence that appears to address many of the AICPA's major professional and public interest concerns (*The CPA Letter*, Nov., Oct., Sept.). The SEC action was a vote "in concept"; the final wording of the rule is expected this month and any specific comments have to await our review of the written rule.

However, based on oral negotiations that took place prior to the vote, I can discuss some of the movement toward the compromise. Our key issues included avoiding a blanket ban on information technology and internal audit outsourcing services, eliminating the major problems caused by the proposed affiliate language, and trying to prohibit an arbitrary approach based on "appearance" factors. We believe considerable progress was made on all of these points.

Significantly, the 10 originally proposed prohibited service areas would be modified. One, advocacy, would be eliminated; seven would be as presently restricted. In the area of internal audit outsourcing, 40% of outsourcing would be allowed for businesses with \$200 million or more in assets. Under an exemption for businesses with less than \$200 million in assets, smaller CPA firms should be unaffected by the final rule.

Information technology consulting would be permissible by meeting a series of tests that can generally be described as assuring management decision making and control over an IT engagement. Thus, there would be no blanket ban on IT services.

Regarding the SEC's proposed proxy statement disclosures, we expect disclosure to be at a high level and focus on three items: audit fees, IT fees and other non-audit fees. In addition, the disclosure would include a statement that the audit committee considered all these services and fees in considering audit firm independence.

Furthermore, affiliate language that was especially troubling for CPA firms of all sizes and members in business and industry will be dropped. Firms and organizations therefore will be able to continue to affiliate with others as they have done historically. While desired "appearance" language advanced by the AICPA will not be achieved, improvement over the original SEC proposal is expected.

Shielding smaller firms from the potential crippling effect of the new rule was — and is — a high priority. Here's what we achieved in particular for smaller firms: it should be easy for them to comply in the information technology area and an internal audit outsourcing carve out will exist for small business.

We worked hard to help the SEC amend its original proposal to uphold audit quality and serve the public interest, and are hopeful that our key concerns will be reflected in the final rule.

Look to an upcoming *CPA Letter* for analysis and details when the rule is released.

—by **Richard L. Miller**, AICPA General Counsel and Secretary.

- Commitment to support the state and national professional organizations by encouraging membership and participation in their activities by all eligible and qualified personnel. As with the obligation to our community, many professionals have a strong desire to give back to their profession. They feel a fraternal relationship with their fellow professionals and want the profession to be as strong as possible. They also benefit by keeping a pulse on the profession and knowing what trends are developing and what practice areas are growing. Fortunately, many of us feel this way, and the profession has many who are very active in the professional societies. There are also many who do not participate due to their inability to gain support from their firm. Obviously, sole practitioners may not be able to spend significant time on state society or AICPA committees.
- Commitment to the ethical standards of the profession. Professionals profess an obligation to due professional care and to only commit to engagements that they can handle competently. The ability to specialize when a firm grows is an easy way to provide complete services because the owner can then concentrate in particular practice areas.

Our clients. Our clients are, of course, who we serve and are vital to the firm. We should also consider our:

- Obligation to perform our assignments at the highest possible level of technical competence, as promptly and diligently as possible and at fees mutually fair and satisfactory. It has also been my experience that a large local firm can provide services more reasonably, in many cases, than the sole practitioner. This is especially true in engagements in which a portion of the engagement can be delegated to the staff within the firm. The owner's rate may be higher in the larger firm, but the ability to delegate sometime results in an average hourly rate lower than that of the owner who must do all the work in a small firm. Therefore, afterwards, the owner provides more valuable service and the client is charged more appropriate rates for the service rendered.
- Obligation to provide the clients with the services they need. One of the most frequent reasons I have heard from clients that left another firm and joined my firm was that they were not receiving the services that they needed from their previous CPA firm. This is not a unique experience: Many clients leave over the lack of services. As their businesses grow, clients will want and deserve the services that are commensurate with

the size and complexity of their businesses. One of the frequent reasons that firms grow is to keep pace with their growing clients. To prevent the clients from leaving them for a firm better suited to handle their expanded needs, practices must grow to be able to meet the needs of now larger client business. This may become more critical as the providers of accounting services offer more nontraditional services.

Our personnel. The staff of our firm are the key ingredient to our success. Therefore, we should consider our:

- Obligation to give the staff opportunity and encouragement to fulfill their ambitions and the obligation to provide an opportunity to earn an income that is commensurate with their abilities, interest, and industry. Once the firm has professional staff, growth becomes an important issue. If the firm has competent staff, they are likely to look to grow in

**The staff of
our firm are
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ingredient to
our success.**

their duties and responsibilities and be compensated accordingly. If the firm does not grow, it will not be able to provide this opportunity and staff will look elsewhere. This will force the firm to continually recruit and train new staff. Client referrals are a key to growth in any practice. Yet if clients are always faced with staff unfamiliar with their accounts, they may not be comfortable in referring the firm to others. The lack of competent staff impairs the growth of the firm. This in turn limits the opportunities for career advancement for the staff; without opportunities, the

best staff leave and this impairs the ability to grow. This often becomes an unending cycle that can only be solved with sufficient growth to provide the staff with opportunities to increase their responsibilities and contribution to the firm. New services may make the firm encounter the issue of non-CPA professionals for the first time. There may be an expectation for advancement that may include non-CPA ownership, depending on the rules of the state where the firm is located.

- Obligation to provide the facilities, resources, and environment that will be conducive to obtaining the best results. Technology provides resources that were unheard of just a short time ago. However, there is a great deal of economy of scale in their use. This means that some resources cannot be taken advantage of unless the firm is large enough to use them efficiently. Hence, another possible reason to grow is to provide the staff with the tools to do the best possible job.
- Obligation to provide reasonable hours to the staff. I have heard of large law firms that require their staff attorneys to have 3,200 chargeable hours per year. Although I know of no CPA firm that puts this type of

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PREVENTING MALPRACTICE CLAIMS: TAX SEASON AND BEYOND

The AICPA Professional Liability Insurance Program provides insurance to over 21,000 CPA firms nationwide, and almost all of these firms render tax services. Claims data compiled by Continental Casualty Company, the program underwriter, indicates that between 1994 and 1999, tax practices generated more than 60 percent of billings for firms insured with the program, and more than 50 percent of all claims¹. Not surprisingly, more than 75 percent of these claims arise from the preparation of individual or business tax returns. Additionally, many of these claims arise from services rendered during the peak of the tax season. This article discusses many of the causes of these claims, specifically, filing errors, computation errors, election errors; problems with estate tax return preparation; and "phantom" tax returns.

Filing errors

Of all Program tax claims, 26 percent arise from filing errors. These claims seek recovery of penalties and interest incurred by the taxpayer due to late filing or failure to file. Incredibly, many of these claims result from the client's failure to sign and send the completed return to the taxing authorities. These claims typically allege that the CPA never sent the completed return to the client for filing, or that the CPA was responsible for filing the return

on the client's behalf but did not do so.

Other claims allege that the CPA failed to prepare tax returns or failed to advise the client of the need to file tax returns that the CPA in fact believed were not within the scope of the engagement. For instance, some claims involving individual tax clients allege that the CPA failed to advise them of the need to file additional state income tax returns when they earned income in states other than the one where they live.

Best practice: Engagement letters are an important and effective tool in the prevention of these types of claims. Engagement letters should spell out the scope of an agreed-upon engagement by identifying the specific tax returns to be prepared, the filing status of the taxpayer, and the CPA firm's deadline for receiving client information needed to prepare the return for timely filing by the client. Firms that send out tax organizers may want to consider including a standard unilateral engagement letter if obtaining signed engagement letters from clients is not practical. The letter should be addressed to the taxpayers for whom returns were prepared in the prior year.

A docketing system is an important tool for firms that perform tax work. Set realistic deadlines and allow staff sufficient time to send applications for extensions to clients who do not send in data on time. Tax returns and applications for extensions should be sent to clients with cover letters containing explicit instructions for completing and filing the forms, including applicable deadlines. If these are sent close

to a filing deadline, request a receipt from the post office or send via certified mail, messenger service, or express delivery service to establish proof of mailing.

Computation errors

Of all program tax claims, 21 percent arise from mathematical or number-transposition errors on tax returns. These errors typically result from inaccurate client data or input errors by the preparer, but can also result from design defects in tax return preparation software.

Best practice: If your clients use firm-supplied tax organizers, verify the client's arithmetic before entering data into a tax software program. Perform spot checks to compare data in completed returns with the information supplied by the client. Regularly check the software manufacturer's Web site for notifications regarding software application problems and for downloads available to update the software. Don't override edit checks built into software programs, but verify that like amounts that appear in more than one place in the return match. Last, maintain a manual quality control system to check returns for completeness and accuracy before submission to the client for filing.

Election errors

Claims involving election errors have been gradually decreasing over the past few years due to changes in the tax code that make it easier to elect and preserve S corporation status. Nevertheless, between

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¹ All claims statistics are based on accounting malpractice claims received by Continental Casualty Company between 1994 and 1999 for the AICPA Professional Liability Insurance Program.

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1994 and 1999, 26 percent of tax practice claims arose from various election errors. Election errors generally occur because:

- The tax preparer failed to timely inform the client of the need to make an election.
- The tax preparer failed to investigate whether or not a previously made election was still appropriate for the client.
- Multiple professionals rendered services to the client, and responsibility for following through on preserving a tax election for the client was not assigned to a specific professional.
- The tax preparer failed to "check the box" on a tax return to preserve an election.

Best practice: Discuss previously made elections with the client each year before preparing their return. If the client makes a decision regarding an election, explain what action needs to be taken. If the client defers a decision, document this as well. Always follow up with a letter to the client recapping the discussion. If the client is also consulting with other professionals regarding either its business or a particular transaction, clearly define your responsibilities in both the engagement letter and follow-up correspondence, and alert the client of the need to follow up with other professionals regarding their responsibilities.

Estate tax return preparation

Few CPAs regularly prepare estate tax returns. Nevertheless, when a client dies, family members often ask the CPA to prepare the return, and many CPAs agree to do so despite their lack of experience in this specialty practice area. In other cases, the CPA is not asked to prepare the return,

but family members assume that the CPA will do so. Delinquent filings are common because of confusion regarding responsibility for preparing the return (especially when attorneys are also rendering services to the estate), or because the CPA fails to docket the engagement to ensure that the return can be filed on time. About half of all estate tax claims result from the CPA's lack of familiarity with estate tax issues and requirements.

Because of the complexities of estate tax law and the large amounts of money involved, simple errors can lead to significant tax liabilities for the estate. In one such claim, a CPA's long-time client died, and the surviving family members expected to pay little estate tax on the transfer of ownership of the family farm.

Unfortunately, in preparing the estate tax return, the CPA failed to make the qualified terminable interest property election. The error was not discovered in time to make a correction, and \$1,000,000 in additional taxes was incurred on the transfer of ownership.

Surviving family members often have conflicting interests regarding liquidation of the assets of a client's estate. Certain actions to minimize estate taxes may benefit one beneficiary but may not be desirable from another beneficiary's perspective, and the CPA can become embroiled in disputes between the parties. Communications can break down, resulting in errors in structuring or executing transactions. Remember that the client is the executor or personal representative of the estate, not the individual beneficiaries of the estate.

Best practice: When a client dies, inform the executor or personal representative of the estate in writing of the need

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QUICK TAX SEASON TIPS

- Use engagement letters that spell out the scope of the agreed-upon engagement by identifying the specific tax returns to be prepared, the filing status of the taxpayer, and the CPA firm's deadline for receiving client information. If tax planning is part of the engagement, be specific in describing what type of advice will be rendered and on what tax topics.
- Document all conversations with the client.
- Use a docketing system and set realistic deadlines.
- If your clients use firm-supplied tax organizers, verify the client's arithmetic before entering data into a tax software program.
- Do not override edit checks built into tax software programs.
- Regularly check the software manufacturer's Web site for notifications regarding software application problems and software updates.
- Maintain a manual quality control system to check returns for completeness and accuracy before submission to the client for filing.
- Discuss previously made elections with clients each year before preparing their return.
- Do not prepare estate tax returns unless you have maintained up-to-date training in this practice specialty.

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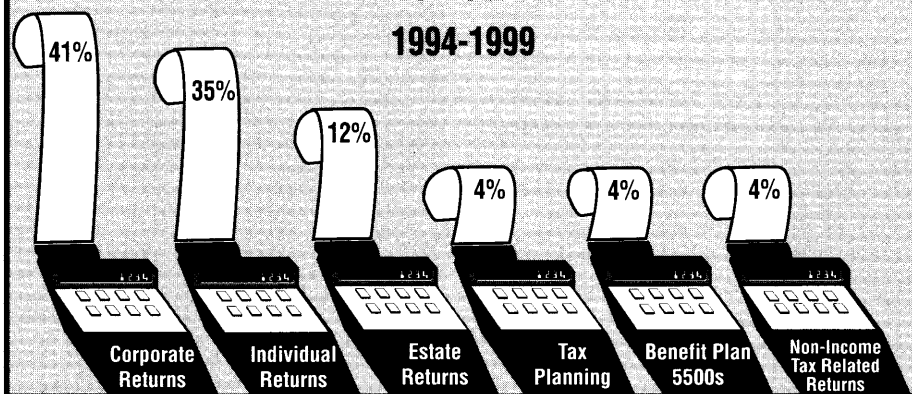
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AICPA Professional Liability Insurance Program Tax Claims by Type of Service*

1994-1999



* Continental Casualty Company

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to file an estate tax return within nine months of the date of death. Don't prepare estate tax returns unless you have maintained up-to-date training in this practice specialty. If you do prepare estate tax returns, obtain signed engagement letters, subject your work product to an internal quality review, and document all conversations with the client and other professionals being consulted. When in doubt, refer the client to a CPA specializing in estate tax work.

If a team of professionals is working to resolve estate issues, the CPA should define his or her own responsibilities both orally and in writing, document all communications, and verify who each professional is representing before discussing estate tax matters with them.

"Phantom" tax returns

Business clients typically must collect and remit taxes other than state and federal income taxes. CPAs who fail to sufficiently define the scope of their business tax engagements can face claims alleging that they failed to advise their clients of the need to collect taxes and file returns for payroll, sales, use, or occupancy taxes, or for sales, use, or income taxes owed on business conducted in another state based on the "nexus" rules. (For more information on nexus rules, view the AICPA's State Tax Nexus Checklist at <http://www.aicpa.org/members/div/tax/nexus.htm>.)

When faced with a large and unexpected tax liability, some clients seek to hold their tax preparer liable for the amounts owed. In the absence of an engagement letter that clearly defines and limits the scope of tax services being rendered, the average judge or juror will view as irrelevant evidence the fact that the CPA firm received no payment to perform such additional services.

Best practice: Again, issuing annual engagement letters is the best defense to these types of claims. The scope of the engagement should be clearly delineated. If the client has engaged the CPA firm to prepare only certain tax returns, identify the specific tax returns. If tax planning is part of the engagement, be specific in describing what type of advice will be rendered and on what tax topics. The engagement letter should advise the client to contact the firm principal-in-charge of the tax practice if additional services are desired.

Tax season can be both frantic and financially rewarding for many CPA firms. With a little advance preparation, CPA firms can minimize the risk of experiencing client relation problems and tax-related malpractice claims.

—By **Sherry Anderson, CPCU**, vice president of Claims, and **Joseph Wolfe**, director of Risk Management, Accountants Professional Liability, CNA Pro, CNA Plaza, Chicago, IL 60685.

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SELLING SECURITIES: DIFFERENT SERVICES, DIFFERENT RISKS

To expand their practice to offer investor services to clients, some CPAs have chosen to take the Series 6 or 7 securities examinations offered by the National Association of Securities Dealers (NASD) and become registered representatives to allow the acceptance of commissions on the purchase and sale of securities. Whereas some may view licensing and registration with the Securities and Exchange Commission (SEC) as mere formalities in order to accept commissions in accordance with state and federal laws, people serving as registered representatives have extensive obligations to both the brokerage firm they serve and their clients. Obligations include, for example, complying with securities laws and regulations, reviewing and retaining client correspondence about securities by the brokerage firm, participating in mandatory continuing education, and documenting that specific securities recommended to clients comply with the client's investment objectives.

Oversight

Registered representatives are subject to extensive oversight by the NASD, the SEC, and state securities regulators. Regulators can inspect the books and records of brokerage firm representatives at any time, and without prior notice. Compliance with applicable laws and regulations is best facilitated by working with a brokerage firm that supplies extensive support and training in this area. For further guidance on this subject, see the AICPA Center for Investment Advisory Services Web site at <http://investmentadvisory.aicpa.org/reg/homepage.htm>.

Claims

Client claims made against registered representatives are subject to binding arbitration under the rules of the NASD. Typical claims include recommending unsuitable investments based on a client's financial plan, failure to conduct due diligence investigations of recommended securities, negligent or intentional misrepresentation

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concerning a recommended security, "churning" of client accounts (making unnecessary sales and purchases to generate commissions), mishandling of funds in client accounts, and improper or untimely trade execution.

Although these claims are subject to binding arbitration, CPA firms or related investment advisory firms that render tax planning or financial planning advice to clients purchasing securities through the firm are also exposed to the risk of lawsuits from clients alleging that these services were negligently rendered. Because each firm manages its tax planning and financial planning business somewhat differently, firms that render these services and employ individuals who are also registered representatives of a brokerage firm should consult with their attorney about appropriate methods to limit the firm's legal liability through firm structure and engagement letters or contracts.

Levels of risk

Recommending different types of securities can present different levels of risk. The key to managing risk, regardless of the type of security being recommended or sold, is providing full written disclosure of the risks associated with the investment. In general, the greater the financial risk associated with investing in a particular class of security, the more detailed the disclosure should be. Consider the following:

Mutual funds. Depending on the type of assets held in a fund, the fund objectives, and the skills and experience of the fund manager, the financial risk of investing in mutual funds can vary widely. Clients should be informed whether they are investing in equity, fixed-income, or balanced funds, whether the fund is load or no-load, what charges are included in administration fees, and the tax implications (after-tax returns) of investing in a particular fund.

Stocks. The financial risk of investing in stocks also can vary widely. Providing

clients with a summary of the due diligence investigation and maintaining documentation evidencing this work is key to defending claims alleging negligent recommendation. The risks of purchasing stocks that experience frequent price volatility should be disclosed in a written document and signed by the client before entering into transactions. For all but the most risk-tolerant and knowledgeable clients, recommending call options (the right of a holder to buy stock) or put options (the right of a holder to sell stock), thinly traded stocks, "penny" stocks, and other stocks that have poor liquidity are high-risk activities that are more likely to lead to malpractice claims.

Bonds. Although U.S. Treasury bonds and municipal bonds carrying a high quality rating from bond rating agencies present a lower risk than some other types of securities, corporate bonds can vary in risk from high quality to so-called "junk" bonds that provide high investment returns and correspondingly higher investment risk. Both investment risk and tax implications should be fully disclosed to clients before investing in bonds.

CPA firms that employ professionals who are registered representatives of a brokerage firm should recognize that selling securities presents risks beyond those presented when providing financial planning and investment advisory services. In addition to monitoring the licensing and regulatory compliance activities of the individuals and the brokerage firm they represent, maintaining adequate documentation of investment-related client disclosures is essential to limiting liability risk for both the registered representative and the CPA firm.

—By **Joseph A. Wolfe**, *Director of Risk Management, Accountants Professional Liability, CNA Pro, CNA Plaza, Chicago, IL 60685.*

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TAILOR COVERAGE TO YOUR FIRM'S SPECIAL NEEDS

Today's CPA firms are performing more new services than ever. These new areas present both increased opportunity for revenue and heightened risk for your firm. Now you can tailor the AICPA Professional Liability Insurance Program's Premier Plan benefits with unique new coverage options to create one convenient, comprehensive plan for your firm. Select only those coverage features your firm needs. Premier Plan options for CPAs include coverage for:

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For more information about the AICPA Professional Liability Insurance Program, call the national administrator, Aon Insurance Services, at (800) 221-3023, write Aon at Aon Insurance services, 159 East County Line Road, Hatboro, PA 19040-1218, or visit the AICPA Insurance Programs Web site at www.cpai.com.

The Professional and Personal Liability Insurance Programs Committee objective is to assure the availability of liability insurance at reasonable rates for local firms and to assist them in controlling risk through education. For information about the AICPA Program, call the national administrator, Aon Insurance Services, at (800) 221-3023, write Aon at Aon Insurance Services, 159 East County Line Road, Hatboro, PA 19040-1218, or visit the AICPA Insurance Programs Web site at www.cpai.com.

indenture on their staff, one thing the profession is saddled with is the enormous demand for time and the inability to spread the workload throughout the year. One of the objectives of growth might be to obtain work that does not have busy season demands and therefore allows better staffing and a more even workload. Thus, for example, audits of school districts or other types of clients with different fiscal years might be a viable target for growth. One of the advantages of assurance services may be the ability to plan the work efficiently.

Our owners. We also have an obligation to ourselves as staff members of the firm and to our investment in the firm. We should consider our:

- Obligation to create an environment that provides the opportunity to offer the services in which we are interested. Because practitioners spend a great deal of time working, they should make work as pleasant as possible by focusing on the types of engagements they particularly enjoy. Some specialties can be done in small boutique practices. Perhaps the practitioner is an expert in retirement plans and has developed a referral-based practice with other CPAs. In this case, practitioners may be better off not diversifying because their referral sources may currently view the practitioners as nonthreatening to the sources' clients and are comfortable in making the referrals. That might change if the practitioners offered competing services. On the other hand, practitioners may desire to work in an area that requires a larger firm. A regional firm owner may decide that Securities and Exchange Commission (SEC) work is very attractive and want to develop a client base that will provide a demand for this work. This may require a larger firm to service these clients.
- Obligation to provide an opportunity to earn an income that is commensurate with the practitioner's ability, interest, and industry. If one looks at the possible reasons for growth discussed to this point, some of the motivations may not lead to any additional revenue but perhaps to a better quality of life. On the other hand, if earnings are low due to productivity, and productivity is low due to lack of work, growth may be the answer. If, upon examination, the conclusion is that the owners are not being fairly compensated due to leverage (the fact that there is too small a ratio of owners to staff), growth may be the answer. New services may change the measures of performance within the owner group. Some work may have lower fee volume but high profitability. Equitable owner performance may have to be redefined.

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TOP FIVE MAP ISSUES

2000 Top Five MAP Issues

(278 participants)

1. Finding, hiring, and retaining staff
2. Keeping up with technology
3. Fee pressures/pricing of services
4. Succession planning/identifying and developing future owners/funding partner retirement
5. Marketing/practice growth

1999 Top Five MAP Issues

(350+ participants)

1. Finding, hiring, and retaining staff
2. Marketing/practice growth
3. Keeping up with technology
4. Delivering high quality service
5. Succession planning/future owners and partner retirement

1998 Top Five MAP Issues

(138 participants)

1. Finding and retaining quality staff
2. Marketing/practice growth
3. Determining and meeting client needs and expectations/delivering high-quality services
4. Capitalizing on consulting opportunities
5. Keeping up with technology

1997 Top Five MAP Issues

(180 participants)

1. Finding, hiring, and retaining staff
2. Keeping up with technology
3. Capitalizing on consulting opportunities
4. Marketing
5. New service development

1996 Top Five MAP Issues

(15 participants — MAP Committee only)

1. Finding, hiring, and retaining quality staff
2. Identifying and developing niche markets
3. Technology
4. Responding to change in the profession
5. Capitalizing on opportunities in consulting

- Obligation to provide an appropriate return on the owner's investment in the firm. Firm owners have a financial stake beyond the fact that the firm provides them with a job. Like any business, there should be an appropriate return on investment. Growth may be a factor to better returns on investment.
- Obligation to provide a plan of succession that will provide for a return of the firm's value upon retirement. Many firms disappear when the principal owner reaches or approaches retirement age. Other firms have appropriate succession planning and exist for many generations of owners. Usually those that plan for succession include growth in their planning. The key is to have qualified staff ready to assume an owner's duties upon retirement. Development of these staff members requires nurturing through many years of increased responsibilities made possible by having available a growing client base.

Long-range goals

After considering the impact of the firm philosophy on its future, the firm is ready to address the consideration of long-range goals.

Where does the firm want to be in the future? Firm owners should take a point some time in the future and imagine what they would like the firm to look like. Typically, a five-year period is used. Owners should be very specific and consider all the areas profiled in the examination of the firm as it now stands. They should write up a specific, realistic profile of the firm of the future, using the following suggestions as guidelines. How are the services performed going to look? Detail the categories and subcategories of desired services. Estimate the volume of work to be done in each category. How many FTEs will there be in the firm? What are the categories of staff? How many chargeable hours per FTE will be expected from the various categories of staff? What is the budget for their nonchargeable time? Do they have adequate time to meet the goals necessary for the firm's development? What will be the billing rate for the various staff levels and for the functions performed? Many firms use multiple billing rates for their staff. They find that in this manner they can establish a rate that has a premium when one is appropriate. However, multiple billing rates also recognize that not all work performed is at an appropriate level and lesser tasks do not demand such a rate. Firms can then manage their profitability by budgeting an average billing rate for each staff person. At what percentage of standard does the firm expect to be working? What will be the overall profitability of the firm? What will the profit be per owner? How much will be retained in the firm? How much investment is needed to

offer new services? Will these answers differ with new services? Clear answers to these questions are essential to having the owners agree with the direction of the firm. They also eliminate the dissatisfactions with and false expectations of firm policies that can occur when retention and owner distributions are not addressed in advance as part of the long-term goals.

Is a merger or acquisition a part of the firm's future? Growth should not be an end in itself. However, growth can lead to a desired objective. It must be realized that in a professional service firm, there is a maximum client volume that can be handled by an owner. Thus, growth in the long-run produces more income, and more owners, but not necessarily more income per owner.

Many CPAs think growth in and of itself is a worthwhile pursuit and many more claim that the firm supports an attitude of professional and community involvement but have policies that are clearly contrary to being able to do so. These CPAs have not taken the time to reflect on where they are, where they want to go, and the steps necessary to get there. By answering the questions in long-range planning, the firm will begin to see whether the best alternative is to try to make the changes internally or whether one or more mergers and acquisitions are appropriate. At this point, mergers can be planned. Growth through mergers and acquisitions should be a planned strategy of the firm and not a reaction to a situation confronted. In this manner, the appropriate data can be accumulated and the strategies can be developed.

—By **Nicholas J. Mastracchio, Jr., Ph.D., CPA**, a consultant on business valuation and professional service firm management in Glenville, New York. Phone: (518)-399-3646; e-mail: Mast@capital.net. Mastracchio is the author of *Mergers and Acquisitions of CPA Firms: A Guide to Practice Valuation*, published by the AICPA.

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PCPS 2000 Member Survey

PCPS has just received the results from its 2000 Member Survey. PCPS conducts this mail survey of its entire membership population every three years. The survey aims to gather information about management and practice issues facing local and regional firms in the profession. Here are some of the highlights:

Tech savvy: The survey found that a full 96% of member firms have Internet access in their offices. Firms use this access mostly for email and online information gathering, using search engines and electronic news services.

Service offerings: Most firms are still offering traditional accounting services: tax planning and compliance, audit and review, financial services, and assurance services. When considering practice growth, a large number of firms plan to grow by adding new services. Some of these expected new service offerings include litigation support, M&A valuation, business performance valuation, compensation and employee benefits, eldercare, and operations management.

Retirement planning: About one-third of all PCPS member firms have succession plans in place, and a similar number have funded retirement plans in place. However, 14% of member firms are considering setting up plans.

Most pressing issue: The survey found that staffing is the most pressing issue for responding accounting firms. They are addressing the staffing shortage in several ways. Firms hope to attract new staff by offering flexible schedules, changes in pay scale, bonus systems and new incentives. Respondent firms also expressed concern over meeting growing client demand, keeping up with technology, standards compliance, marketing and succession planning.

The survey was distributed to the full PCPS membership — about 6,500 firms. PCPS received more than 1,400 responses, an extraordinarily high rate of about 22%. The questionnaires were distributed to managing partners at firms in all 50 states, DC, and Puerto Rico, representing five regions of the U.S. (West, Southwest, Midwest, Southeast, Northeast).

PCPS uses the findings of its Member Survey to tailor products and services to member firms. In polling its membership, PCPS hopes to identify ways it can best help its firms to compete and succeed in a changing competitive marketplace. One idea that has already surfaced

is the "Top Talent" Staffing Survey (see below), which will identify ways firms can effectively attract and retain talented staff.

Staffing Survey

PCPS has just distributed its "Top Talent" Staffing Survey. The survey is addressed to managing partners and asks them to identify one or two of their most valued employees. These "top talents" will then complete the questionnaires, offering a first-hand look into best practices for attracting and retaining the best staff possible.

The survey asks respondents about which employee benefits (compensation, company culture) motivated them to join their respective firms and, equally as important, which factors encourage them to remain with their firms.

Results of the survey will be shared at the 2000 Forum on Staffing in Denver and the Practitioners Symposium in Orlando. They will also be available on the PCPS Web site at www.aicpa.org/pcps. If you do not receive a survey packet and you would like to participate, please call 800-CPA-FIRM.

Update Your Firm's Contact Information!

The PCPS online directory of member firms was rated as one of the most valuable PCPS member services. Is your firm information up to date? You can check by visiting the PCPS Web site at www.aicpa.org/pcps. Using your member username and password, you can immediately update your information.

Top 5 MAP Issues (See box on page 5.)

Staffing ranks as the top concern, according to a survey conducted by the PCPS Management of an Accounting Practice Committee. Staffing has been identified as the top concern for five years, since 1996. Keeping up with technology has also held a steady position in the top five for the past five years. This is the first year fee pressure/pricing of services has surfaced as a top-priority issue. In 2000, marketing/practice growth — second in last year's poll — dropped to fifth place.

The survey, distributed as a "back-page questionnaire" in the August 2000 *Practicing CPA*, returned responses from more than 250 CPA firms ranging in size from one professional (sole practitioner) to 50 or more professionals. The PCPS MAP Committee, working with state society MAP representatives, asked participants to rank their top five practice management issues. Staffing ranked as the number one issue, followed by keeping up with technology, fee pressures, succession planning, and marketing/practice growth.

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continued from page 7 — **Top Five Issues**

The MAP Committee uses the results of the poll to help guide the development of new programs and initiatives. Based on this feedback, the committee develops action plans (such as benchmarking studies, videos, articles, online communications and live presentations) that directly address the profession's most relevant practice management issues.

To participate in the 2001 poll, contact your state society MAP representative or Dave Handrich, MAP staff liaison at 800-CPA-FIRM or dhandrich@aicpa.org.

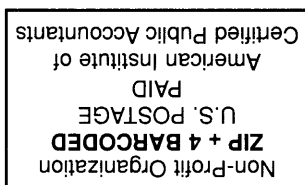
Upcoming Dates

Mark your calendars! Practitioners Symposium will be held June 10-13 in Orlando and the Staffing Forum will be

held May 20-22 in Denver. Join us at the AICPA Forum on Succession Planning December 2-4 in New Orleans. The 2001 NAAATS conference is scheduled for July 19-20 in Seattle.

LETTERS TO THE EDITOR

The Practicing CPA encourages its readers to write letters on practice management issues and on published articles. Please remember to include your name and your telephone and fax numbers. Send your letters by e-mail to pcpa@aicpa.org.



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